Supreme Court, U.S.
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No. 85-1060.

In the
Supreme Court of the United States.

OCTOBER TERM, 1985.

RAYTHEON COMPANY,
PETITIONER,

v.

CVD, INCORPORATED, ROBERT DONADIO
AND JOSEPH CONNOLLY,
RESPONDENTS.

Petitioner's Reply to Respondents' Brief in Opposition to Petition for Writ of Certiorari.

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I. THE ISSUES RAISED IN THIS COURT WERE EITHER RAISED BELOW OR RESULTED FROM THE NOVEL OPINION OF THE COURT OF APPEALS.

Respondents in their brief in opposition to the petition for writ of certiorari (Res. Br. 10)[1] suggest that certain issues in the petition were not raised in the court below and therefore this Court should not grant the writ.

[1] References in the Brief are the same as in the Petition except for the added reference to respondents' Brief in this Court (Res. Br.).

Respondents' argument ignores the fact that the district court's legal analysis of the antitrust issue depended on an interpretation of state law. Petitioner's brief on appeal to the Court of Appeals addressed the state law issue. The Court of Appeals, however, did not discuss the district court's analysis. Instead, the Court of Appeals formulated a new theory of action based on federal antitrust law and thereby invalidated the license agreement. Critical First Amendment issues arose from that decision. It is therefore appropriate for this Court to grant the writ. See e.g. *Berkemer* v. *McCarty*, 468 U.S. , 82 L.Ed.2d 317, 337, 104 S.Ct. 3138 (1984), *Carlson* v. *Green*, 446 U.S. 14, 64 L.Ed.2d 15, 100 S.Ct. 1468 (1980), *Youakim* v. *Miller*, 425 U.S. 231, 47 L.Ed.2d 701, at 705, 96 S.Ct. 1399 (1976).

The issue in the trial was the validity of the license agreement executed on February 15, 1980. Respondents contended that the license agreement was invalid and therefore a restraint on trade because they entered the agreement as a result of duress and coercion. The district judge, instead, instructed the jury as follows:

> However, the license agreement was an agreement resolving a disputed claim and is enforceable for its term if it was made in good faith, even though you find that Raytheon's claim to trade secrets was incorrect. . . That license agreement is enforceable because the consideration for it was forbearance to sue. There is no evidence of duress or coercion sufficient in law to avoid that contract.

(Tr. 3373-3374.)

The district judge ruled on the supposed basis of an old Massachusetts case, *Chandler* v. *Sanger*, 114 Mass. 364 (1874), that if the jury found that petitioner misrepresented it

had trade secrets, the jury could invalidate the license agreement even though the individual respondents did not rely on petitioner's representations. The district judge in a post-trial memorandum denying judgment notwithstanding the verdict said: "Defendant [Petitioner] says, correctly, that there was no evidence of reliance by the plaintiffs on the allegedly fraudulent statements. The species of fraud that was submitted to the jury under Massachusetts law was that described in *Chandler* v. *Sanger*, 114 Mass. 364 (1874), namely, the fraudulent assertion of a claim and threat of litigation. Reliance is not an element of this case. . ." (App. C, at 32a).

The district judge was mistaken. *Chandler* v. *Sanger*, 114 Mass. 364 (1874) does require reliance. It is not an exception to the Massachusetts' rule that a fraudulent misrepresentation sufficient to invalidate a contract must be relied upon by the injured party. *J. Abrams & Co.* v. *Clark*, 298 Mass. 542 (1937), *Liberty Leather Corp.* v. *Callum*, 653 F.2d 694 (1st Cir. 1981).

The First Circuit recognized that the district judge was in error in his reading of *Chandler* v. *Sanger*. The Court of Appeals said: "Since the plaintiffs [respondents] did not rely on any of Raytheon's [petitioner's] misstatements, and entered into the agreement while represented by competent counsel, Raytheon contends that plaintiffs are precluded from relief. In an action to rescind the contract or recover damages on a theory of fraud, under Massachusetts law this contention might have merit." (App. A, at 18a, 19a.) The Court of Appeals neither cited the *Chandler* case nor discussed the district court's analysis.

Instead, the Court of Appeals for the first time formulated a rule that the assertion of trade secrets with the knowledge that none exist, coupled with the threat to institute litigation in order to exact a licensing agreement, violates the antitrust laws (App. A, at 10a, 11a). This was a novel rule.

The Court of Appeals' holding goes far beyond even the rule espoused by respondents. In their brief in the Court of Appeals, relying on *Walker Process Equipment Inc.* v. *Food Machinery & Chemical Corp.*, 382 U.S. 172 (1965), respondents articulated the rule applicable to this case as: "The assertion of unfounded claims in bad faith, knowing that there is no basis for such claims, may violate federal antitrust law if it is done in an attempt to restrain interstate commerce or to monopolize."

In petitioner's petition for rehearing (including suggestion for rehearing en banc), petitioner pointed out that the Court of Appeals' holding brought directly into play this Court's decision in *Bose Corporation* v. *Consumers Union of United States*, 466 U.S. 485 (1984). The Court of Appeals denied the petition without explanation (App. G at 39a).

Once the Court of Appeals ruled, as it did, that "the threat of unfounded trade secrets litigation in bad faith is sufficient to constitute a cause of action under the antitrust laws" (App. A at 11a) and cited *Eastern Railroad Presidents Conference* v. *Noerr Motor Freight*, 365 U.S. 127 (1961), and *United Mine Workers* v. *Pennington*, 381 U.S. 657 (1965), the decision raised First Amendment issues for the first time in the litigation. Thus, petitioner in its petition for rehearing contended that if the Court of Appeals was for the first time going to formulate such a rule, the Court of Appeals had a duty as a matter of constitutional law under *Bose Corporation* v. *Consumers Union of United States*, 466 U.S. 485 (1984), to make an independent review of the record to determine if there was clear and convincing evidence that petitioner knew, when it told respondents that it might have to go to court, it had no trade secrets.

Contrary to the assertion by respondents (Res. Br. 13) that the "court of appeals made an extremely thorough review of the evidence in the record," the Court of Appeals did not and

does not profess to have made an independent review consistent with *Bose*.

Petitioner in its petition for rehearing to the Court of Appeals noted that all the Court did was accept respondents' statement of the evidence and from that conclude that the jury could have inferred bad faith. As petitioner advised the Court, respondent's statement of the evidence was beside the point. It ignored uncontroverted evidence by two of the world's leading experts in the field that there were critical engineering designs and details that were clearly trade secrets.[2] The Court of Appeals never reviewed the record independently to determine if there was clear and convincing evidence that what petitioner said were trade secrets were not. Instead, the Court of Appeals recited evidence offered by respondents that had nothing whatsoever to do with what petitioner considered were trade secrets.

Petitioner observed in its petition for rehearing that all the panel of the Court of Appeals had done was recite facts from which the jury "could have inferred" an intent "to restrain competition." (App. A at 16a, 17a.) But the Court of Appeals did not in accordance with *Bose* affirmatively identify clear and convincing evidence that petitioner knew its claimed trade secrets were not trade secrets under Massachusetts law.

II. The License Agreement did Not Require CVD Inc. to Pay Unreasonable Royalties.

Respondents contend that the license agreement required CVD, Inc. to pay Raytheon "massive royalties." (Res. Br. 19.)

[2] Respondents state that Raytheon's reports to the government contained details "sufficient to enable a competent engineer to design a complete cvd system of the type used by Raytheon," and refer to Tr. 1084. In fact, the transcript reference is to the cross-examination of respondent Joseph Connolly who conceded that the schematic diagrams in the reports were insufficient to permit the design of the critical components of Raytheon's system (Tr. 1085-1088).

In fact, respondents projected sales for CVD totalling in the five year period in excess of $7,000,000, and after accounting for royalties paid to petitioner of about $1,000,000, a net profit before income taxes of about $2,000,000. (E. 509.)

The district judge ruled that the royalty rate was reasonable (Tr. 3379). There was no evidence that the rate was inconsistent with standard and accepted royalties in the industry.

III. The License Was an Agreement to Settle a Dispute Out of Court.

Respondents contend (Res. Br. 19) that there was no consideration for the license agreement and in any event, the agreement purported to license non-existent trade secrets (Res. Br. 20).

The district judge, however, ruled that there was valid consideration (Tr. 3373-3374). Respondents did not cross-appeal that ruling. The comment by the Court of Appeals that there was "no valid consideration" (App. A. at 24a) is a clear example of the Court of Appeals," willingness to accept without critical examination the bad faith finding: If the jury found bad faith, forbearance to sue would be forbearance from a bad faith suit and therefore there was no consideration. The rationale is not logical. The cart is before the horse.

In addition, the agreement did not license non-existent trade secrets. Because the existence and nature of trade secrets was in dispute, the agreement by its terms was a settlement of that dispute:

> "Whereas, LICENSOR and the Principals, now joined by LICENSEE, *have a dispute over the extent and scope of LICENSOR's Trade Secrets* and/or the inevitability of use thereof in LICENSEE's principal

> initial business activity the design, development and manufacture of Material and without conceding the correctness of any parties' position in this dispute and without prejudice to any rights of the parties in the event the Agreement is terminated before its normal expiration under subsection 6.01 *are willing to settle such dispute* under the terms and condition hereinafter stated."

(E. 257) (emphasis added).

IV. This Case Presents Issues of Material Importance Concerning Antitrust and Trade Secret Law and the Policy in Favor of Settlement of Disputes.

Contrary to respondent's suggestion (Res. Br. 20), the facts in this case are a common place occurrence in the relationship of a high technology employer and departing engineers who may be privy to confidential information and trade secrets. If employers cannot resolve disputes about the nature and extent of trade secret information possessed by a departing employee, without the threat of antitrust litigation based on an after-the-fact assessment of whether the employer had trade secrets, the rule in this case will substantially hinder out-of-court settlements.

Petitioner believes that this case involves substantial issues of antitrust policy and respectfully suggests to this Court that

the Court request the views of the Antitrust Division of the United States Department of Justice.

Respectfully submitted,

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